DOCUMENT RESUME

ED 292 426 HE 021 311

TITLE	Financial Management: Overall Plan Needed To Guide System Improvements at Education. United States General Accounting Office Report to the Secretary of Education.
INSTITUTION	General Accounting Office, Washington, D.C.
REPORT NO	GAO/AFMD-88-15
PUB DATE	Dec 87
NOTE	60p.
AVAILABLE FROM	U.S. General Accounting Office, P. O. Box 6015, Gaithersburg, MD 20877 (first 5 copies free; additional copies, $2.00 each prepaid; 25% discount for 100 or more mailed to the same address).
PUB TYPE	Reports - Evaluative/Feasibility (142)
EDRS PRICE	MF01/PC03 Plus Postage.
DESCRIPTORS	*Accounting; *Federal Aid; *Federal Programs; Higher Education; Loan Repayment; *Management Systems; *Money Management; Program Evaluation; State Federal Aid
IDENTIFIERS	*Department of Education

ABSTRACT

The U.S. Department of Education's financial management environment and effectiveness are described, together with the reliability of its accounting and internal control systems for the management of the money it gives or lends to schools, individual students, states, and local education agencies. The study found that key accounting and related internal control systems operated by the Department and its fund-receiving schools have serious weaknesses. Consequently, billions of dollars in financial resources are not adequately protected from fraud, waste and mismanagement. In addition, the Department's financial reports were found to be unreliable and not derived from its accounting system. Principal findings were: (1) loan records for the Higher Education Facilities and College Housing loan portfolios were inadequate; approximately $75 million would be required to bring the files up to commercial standards in order to sell them to the public; (2) the property accounting system is insufficient for proper Departmental control; (3) accounting weaknesses result in erroneous Pell Grant disbursements; and (4) the Department's general ledger system contains unreliable data because of inadequate and inefficient computer systems. Appendix I consists of a financial management profile of the Department in five tables that provide data on budget requests, estimated loan account balances, statements of financial condition for fiscal years 1982, 1984 and 1985, and the purposes of the Department's 29 accounting systems. Appendix II provides comments from the Department of Education. (KM)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

HE

United States General Accounting Office

GAO

Report to the Secretary of Education

December 1987

FINANCIAL MANAGEMENT

Overall Plan Needed To Guide System Improvements at Education

ED272426

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)
☑ This document has been reproduced as received from the person or organization originating it.
☐ Minor changes have been made to improve reproduction quality.
• Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

CA 811

GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

B-219894

December 31, 1987

The Honorable William J. Bennett
The Secretary of Education

Dear Mr. Secretary:

This report discusses the results of our review of the Department of Education's financial management structure and systems. The purposes of our review were to assess the adequacy of financial management system support to managers in carrying out program and administrative operations, to identify major system weaknesses, and to evaluate Education's actions to address identified weaknesses. We determined that additional actions are needed to more effectively focus management attention on financial management system improvement actions.

The report contains recommendations to you in chapter 4. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget, and to the Chairmen, Senate Committee on Governmental Affairs and House Committee on Government Operations. We will also make copies available to others upon request.

Sincerely yours,

Frederick D. Wolf
Director

Executive Summary

Purpose

Each year, the Department of Education gives or lends about $16 billion of taxpayer money to schools, individual students, states, and local education agencies. The Secretary of the Department is responsible for these funds and, in some cases, their eventual repayment. Thus, the Department must have effective systems of accounting and internal control with which to monitor these funds and ensure that they are awarded according to regulations.

This report describes the Department of Education's financial management environment and effectiveness as well as the reliability of its accounting and internal control systems.

Background

The Department of Education was established in 1979 as a cabinet-level agency to foster educational opportunities for all individuals, to support state and local efforts to meet education needs, and to improve the quality of education through research. To meet the greater part of these goals, the Department acts as a financial holding company by providing funds to states, local education organizations, schools, and private organizations which carry out day-to-day education programs. The Department also provides funds to individuals to defray education costs. The Department funds these operations through grants, contracts, direct loans, and loan guarantees.

Results in Brief

Key accounting and related internal control systems operated by the Department of Education and its fund-receiving schools have serious accounting and internal control weaknesses. As a result, (1) billions of dollars in appropriated funds and other financial resources are not adequately protected from fraud, waste, and mismanagement, and (2) the Department's financial reports are unreliable and are not derived from its accounting system.

Principal Findings

Poor Loan Records Hinder Sales

Loan records for the Department of Education's $2.6 billion Higher Education Facilities and College Housing loan portfolios were inadequate. Specifically, for 49 randomly selected loans of a statistically valid sample of loans GAO selected for review, 5 loan files could not be located, and almost all files reviewed were missing key documents. For example, 11

of the 44 files were missing their most essential papers—the loan agreements. In light of the administration's proposal to sell federally held loans to the public, the Department retained a private financial market consultant for advice. The consultant found that the Department's loan files were substandard and estimated that it could cost up to $75 million to bring the loan files up to commercial standards in order to sell them to the public. (See chapter 2.)

Property Accounting System Insufficient

The Department lacks adequate accounting for and control over property, much of which is held and used by contractors and grantees. The Department's property systems do not record automated data processing equipment, regional office property, and property in which the government has a financial interest that is held and used by contractors and grantees. As a result, the Department does not know the value and location of all the property it owns and, consequently, cannot manage it nor protect it from fraud, waste, and mismanagement. (See chapter 2.)

Accounting Weaknesses Result in Erroneous Grant Disbursements

The Department of Education relies on accounting systems run by schools to disburse $2.9 billion annually under its Pell Grant Program. GAO's review disclosed weaknesses in the schools' accounting systems which result in hundreds of millions of dollars in erroneous disbursements each year. For example, a recent GAO report pointed out that erroneous payments by schools totaled about $600 million over a 2-year period. The key control the Department has over the schools' accounting systems is biennial audits performed by states, the Department's Inspector General, and independent public accounting firms. The Department does not, however, adequately ensure that accounting system weaknesses identified by these audits are corrected. Thus, the system weaknesses and related erroneous grant payments persist. (See chapters 2 and 3.)

General Ledger Inadequate

Education's general ledger system, which should be used to manage its financial operations and be the source of the agency's financial statements, contains unreliable data because of inadequate and inefficient computer systems which support the general ledger and subsidiary accounting systems. For example, Education's general ledger showed outstanding loan balances of $271 million for one college housing program while the balance in the subsidiary account for that program

totaled only $2 million. The difference arose because the accounting system cannot correctly transfer computerized information from the subsidiary account to the general ledger. Because it did not have confidence in the reliability of the information in the accounting system, the Department estimated the value of much of its assets when reporting its financial condition. (See chapter 2.)

Recommendations

GAO recommends that the Secretary of Education ensure the adequate design of an overall financial management system. The design should address current problems with both the general ledger and subsidiary accounting systems and should include goals, priorities, and milestone dates for component system projects. (See chapter 4.)

Agency Comments

In a written response to a draft of this report and in further discussion with GAO, Education cited a number of actions that had been accomplished or planned in response to the draft report. Because of the detailed nature of Education's comments, they are included in the appropriate sections of this report. (See appendix II for Education's specific comments.)

Contents

Executive Summary		2
Chapter 1 Introduction		8
	Background	8
	Program Operations Are Highly Decentralized	9
	Financial Internal Controls and Accounting Systems Are Highly Decentralized and Complex	9
	Objectives, Scope, and Methodology	11
Chapter 2 Weaknesses in Accounting Systems Affect Program Delivery and Resource Control		13
	Higher Education Facilities and College Housing Loans Not Adequately Controlled	13
	Lack of Accountability and Control Over Personal Property	16
	Weak Controls Over Pell Grant Program Result in Erroneous Payments and Impede Collection of Overpayments	18
	Contract and Grant Accounting Systems Do Not Support Management Needs	23
	General Ledger System Cannot Produce Auditable Financial Statements	24
	Agency Comments and Our Evaluation	27
Chapter 3 Causes of Weaknesses in Education's Accounting Systems Known but Remain Uncorrected		28
	Education's Annual Plans Do Not Give Adequate Priority to Financial Management Problems	28
	Automated Data Processing Improvement Plans	30
	Inadequate Follow-up on Contractor and Grantee Audits	33
	Agency Comments and Our Evaluation	35
Chapter 4 Conclusions and Recommendations		36
	Conclusions	36
	Agency Comments and Our Evaluation	37
	Recommendations	38
Appendixes		
	Appendix I: Financial Management Profile	40
	Appendix II: Comments From the Department of Education	52

Tables

Table I.1: Summary of the Department of Education's Fiscal Years 1985 to 1987 Budget Requests 45
Table I.2: Estimated Loan Account Balances for Direct Loans and Loan Guarantees for Which Principal and Interest Payments Are Current 47
Table I.3: Estimated Loan Account Balances for Direct Loans and Loan Guarantees for Which Principal and Interest Payments Are Not Current 47
Table I.4: Statements of Financial Condition for Fiscal Years 1982, 1984, and 1985 as Reported in Treasury's "Bulletin" 49
Table I.5: Accounting Systems 50

Abbreviations

ADP	automated data processing
FMFIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
IG	inspector general
OMB	Office of Management and Budget
POC	principal operating component

Chapter 1

Introduction

Background

The Department of Education was established in 1979 as a cabinet-level agency to foster educational opportunities for all individuals, to support state and local efforts to meet education needs, and to improve the quality of education through research. Education fulfills these responsibilities through five broad program areas: (1) grants to states and local education agencies to fund educational programs, (2) financial assistance to individual students, (3) financial assistance to higher educational facilities, (4) educational research, and (5) financial support for the operation of special educational institutions.

Education manages several specific programs that are designed to implement these broad program areas. They fall into three categories: (1) grants and contracts, (2) direct loans, and (3) guaranteed loans. Specifically, Education provides grants to states and local education agencies to fund education programs such as those for adult education, grants and contracts to private organizations to study education issues, and grants to individual students to help defray education costs. Direct loans are provided to students to help pay postsecondary education costs and to colleges and universities for building construction and renovation programs. Under loan guarantees, Education repays loans made by private lenders to students to pay for education costs if the students/borrowers default. It also pays lenders for program administrative costs and for certain interest costs on behalf of the students/borrowers.

The Department is headed by the Secretary of Education who is supported by an Under Secretary. Several staff offices assist the Secretary in developing overall policy and management guidance. Six principal operating components (POCs) work through contractors, grantees, postsecondary education institutions, state and local governments, and private financial institutions to carry out day-to-day operations of Education's programs. Education operates 10 regional offices throughout the country to represent the Secretary and to carry out Education's programs at the state and local level. Education had a staff of 4,177 as of fiscal year 1986, and the fiscal year 1986 appropriation request was about $19 billion. More detailed descriptions of Education's programs, financial management systems, and organizational structure are presented in appendix I.

We have previously reported that many agencies, including Education, urgently need to upgrade their financial management systems. This report describes Education's accounting and related internal control systems, assesses the effectiveness of certain systems, and discusses Education's efforts to correct system and control problems. This report also

points out that Education's systems do not fully meet the Comptroller General's accounting principles and standards, do not provide managers with reliable information, and do not operate to adequately protect agency resources from fraud, waste, and mismanagement. Finally, the report includes recommendations to the Secretary of Education on actions top management needs to take to be assured that accounting system and internal control problems are expeditiously corrected.

Program Operations Are Highly Decentralized

Education does not directly carry out most day-to-day program and administrative operations for its grant and contract, direct loan, and loan guarantee programs. These activities are primarily carried out by representatives which are under agreement with Education, including state and local education agencies, contractors and grantees, and more than 7,000 postsecondary education institutions. Education functions as a financial holding company. Specifically, it promulgates program policies and regulations, reviews and approves representatives' program and administrative plans, provides funds to representatives, oversees representatives' operations, and receives and reviews representatives' summary financial reports on the results of program and administrative operations.

Financial Internal Controls and Accounting Systems Are Highly Decentralized and Complex

Education's financial internal control and accounting systems parallel the decentralized structure of its program and administrative operations. Education maintains overall summary-level financial internal controls and accounting systems for its appropriated funds and other financial resources, but it depends on similar controls and accounting systems operated by its representatives to ensure that funds and other resources are used in accordance with the laws which established its programs and that its resources are protected from fraud, waste, and mismanagement. Overall, Education does not directly maintain internal control and accounting systems for day-to-day program and administrative operations and for use of its appropriated funds and other financial resources. Education primarily depends on audits of representatives' operations to ensure that use of its appropriated funds and other financial resources is proper.

Education operates 30 accounting and related internal control systems to (1) record and control appropriated funds and other financial resources provided to its representatives, (2) record summary financial information on the financial results of program and administrative operations reported to it by its representatives, (3) prepare financial reports

for use by managers to monitor the operations of its representatives, and (4) prepare summary financial reports on the results of program and administrative operations and the status of appropriated funds and financial resources required by individuals and organizations outside Education. Detailed financial information on the use of appropriated funds and other financial resources which is recorded in Education's accounting systems relates primarily to payroll costs for its employees and personal property used by Education's organizational components. These costs are only a small part of Education's annual spending authority. For example, in fiscal year 1986, the President's budget request included about $19 billion for Education, and, of this amount, about $312 million was requested for internal department operations.

In contrast, Education's representatives controlled, through their accounting and internal control systems, day-to-day use of most of the $19 billion in spending authority requested by the President for Education's programs in fiscal year 1986. Of this total, about $9.3 billion was requested for grants to state and local education agencies to fund programs such as vocational, handicapped, and special education programs. For these grant programs, Education determines the amount of funds for each grant based on a statutory formula or grant proposal; provides funds to the grantees and records the aggregate amount of the grant award in its accounting records; and accepts, reviews, and records summary financial information on fund use which is periodically submitted by grantees. Grantees, on the other hand, authorize and determine the use and amount of actual expenditures and are responsible for ensuring that expenditures are proper.

Similarly, about $8.8 billion in requested fiscal year 1986 spending authority was earmarked for financial assistance grants for needy students. This total included about $5.1 billion in grants and about $3.7 billion in interest subsidy costs and compensation for defaulted loans under Education's guaranteed student loan program. The postsecondary education institutions participating in these programs—more then 7,000 schools—ensure that students eligible for grants and loan guarantees are enrolled in eligible education programs, ensure that students maintain satisfactory academic progress, authorize grants, compute grant amounts, and maintain detailed program accounting records. Private lenders authorize and make guaranteed loans, determine interest subsidy costs, collect loan principal and interest payments, and bill Education for interest subsidy costs. Education's accounting systems record summary financial information on funds provided to schools and private

lenders, on expenditures made by the schools, and on costs incurred by lenders.

The chief control Education has over the day-to-day financial operations of its representatives—particularly postsecondary educational institutions—is biennial independent audits performed by organizations such as states, Education's Inspector General (IG), and public accounting firms. Education depends on these audits to disclose improper expenditures and costs as well as weaknesses in representatives' accounting and internal control systems.

Accounting system standards have been published in GAO's Policy and Procedures Manual for Guidance of Federal Agencies, titles 2 through 7, for all agencies to follow. These standards require that agency accounting systems be an integral part of the agency's total financial management system and provide sufficient discipline, effective internal controls, and reliable and useful information. The standards also call for the accounting systems to produce financial statements on agency operations as a whole. This type of reporting has proven a noteworthy success in materially upgrading the level of financial management wherever it has been used in both the public and private sectors. By calling for the financial statements, the standards reinforce the requirement for basic year-end accounting by management to disclose (1) its stewardship of resources entrusted to it and (2) its performance for the period.

Objectives, Scope, and Methodology

The objectives of our review were to (1) identify and describe Education's financial management systems, (2) determine if these systems support reliable reports on the results of financial operations, (3) determine if these systems effectively account for and control the department's funds and other resources, (4) identify any major system weaknesses, and (5) examine Education's actions to correct system weaknesses. Financial management is a term that encompasses the activities of budget formulation, accounting and budget execution, planning and programming, and audits and evaluations. The principal focus of this report is on accounting and budget execution. However, the four financial management activities are largely inseparable. Thus our discussions about accounting systems will at times refer to other financial management activities.

We conducted our review between September 1985 and October 1986 in accordance with generally accepted government auditing standards.

Work was performed at Education's headquarters in Washington, D.C., as well as at a contractor's data processing center in Norfolk, Virginia. In addition, work was performed at contractor and grantee locations including the Federal Reserve Bank, Richmond, Virginia; National Captioning Institute, Falls Church, Virginia; Reading Is Fundamental, Washington, D.C.; and Group Operations, Inc., Washington, D.C.

To identify and describe Education's financial management system, we reviewed policies pertaining to Education's programs and organization; agency descriptions of financial management systems; and previous reports by GAO, Education's Inspector General, consultants, and Education pursuant to the Federal Managers' Financial Integrity Act (FMFIA). We also spoke extensively with Education officials and with program, data processing, and financial management representatives.

To evaluate accounting system operations, we selected six accounting systems that support program and financial management functions. The accounting systems selected were those supporting the following programs: Higher Education Facilities and College Housing Loan, Pell Grant, Grant Management, Personal Property Management, Property Inventory, and Education's general ledger accounting systems.

We chose these systems because they accounted for, controlled, and reported on selected types of financial resources managed by Education—that is, direct loans, grant payments, and personal property. In addition, we selected Education's general ledger system for review to enable us to determine whether Education's financial statements flow from its accounting system. We examined the system designs to detect possible weaknesses, reviewed the results of earlier evaluations of the systems, and tested the reliability of system information by comparing data among systems, conducting physical inventories, and observing system operations.

To examine Education's efforts to correct system weaknesses previously identified in GAO reports, Education's FMFIA reports, and findings of other audit organizations, we reviewed the previously reported problems, Education's goals for correcting the problems, the audit resolution systems, and Education's data processing improvement plan. We also discussed Education's corrective actions with agency officials.

Weaknesses in Accounting Systems Affect Program Delivery and Resource Control

Key accounting systems operated by Education and many of its contractors and grantees do not effectively account for and control billions of dollars in appropriated funds and other resources. Specifically, in the systems we reviewed, we found that

- records supporting $2.6 billion in Higher Education Facilities and College Housing loans require costly improvements and, in some cases, complete reconstitution of the loan files to prepare them for planned sale to the public;
- the Department lacks effective accountability and control over millions of dollars in personal property and cannot adequately protect the property from fraudulent use, waste, and mismanagement;
- Pell Grant accounting and control weaknesses affect $2.9 billion in fiscal year 1985 annual postsecondary student financial aid and result in millions of dollars in erroneous payments;
- management needs are not supported by Education's accounting and reporting systems for contracts and grants and, as a result, additional costs are incurred to manually prepare required reports; and
- the Department cannot produce financial statements supported by reliable accounting systems under general ledger control.

Top management at Education is aware of most of its accounting system problems; however, as discussed in chapter 3, it does not have effective processes in place to ensure that problems are prioritized and corrected promptly. Correcting accounting system problems will require a strong management commitment.

Higher Education Facilities and College Housing Loans Not Adequately Controlled

The Department lacks effective accountability and internal controls over its Higher Education Facilities and College Housing loan portfolios which total about $2.6 billion. As a result, a consultant to Education estimated that it may cost Education $75 million to review the loan portfolio and bring it up to market standards to prepare it for sale to private investors under the administration's pilot loan sale proposals for fiscal years 1987 and 1988.

Education maintains the individual loan files for the Higher Education Facilities and College Housing loans. These files include the loan agreements between the government and its borrowers and, accordingly, serve as the documentary evidence of Education's loan assets. Education maintains summary loan financial records, while the Federal

Reserve Bank in Richmond, Virginia, under an agreement with Education, collects loan principal and interest payments and maintains detailed loan accounting records.

We tested the completeness of Education's individual loan records by attempting to locate and review records for randomly selected borrowers drawn from the detailed accounting records maintained by the Federal Reserve Bank in Richmond, Virginia. Specifically, we attempted to locate and review files for 49 borrowers randomly selected from about 3,000 borrowers listed in the detailed accounting records. To substantiate Education's loan assets, Education's individual loan files on each borrower should include the loan agreement, borrower financial statements, legal documents related to the trust, and the loan amortization schedule.

We could not locate any records for 5 loans, or 10 percent of the loans, and most of the located records were missing key documents. Of the 44 selected loan records that we could locate,

- 11, or 25 percent, were missing the loan agreements;
- 43, or 98 percent, were missing the borrower financial statements;
- 30, or 68 percent, were missing the legal documents related to the trusts; and
- 25, or 57 percent, were missing the amortization schedules.

In addition to the missing documents being indicative of internal control breakdowns, the incomplete loan records will prove costly as Education proceeds with the planned sale of certain college housing loans under the President's proposed program of loan asset sales to the public. In September 1986, we reported[1] that a private financial consultant retained by Education to advise it on sale structures and strategies, found that the college housing loan files were in a substandard condition and estimated that the cost of reviewing loan files and bringing them up to commercial financial market standards could be as high as $75 million. This work would have to be done to allow Education to sell its loans without recourse to the government—that is, without any government promises to compensate for possible future losses. Generally, market standards require that private lenders maintain the types of documents that we found missing.

[1]Loan Asset Sales: OMB Policies Will Result in Program Objectives Not Being Fully Achieved (GAO/AFMD-86-79, September 26, 1986).

Under the sale plan we reviewed, Education would offer for sale to the public $2.1 billion of its $2.2 billion in College Housing loans while it would hold $89 million in these loans that are in default. Education would also continue to hold more than $300 million in Higher Education Facilities loans.

Education began a program in early 1987 offering borrowers the opportunity to prepay their loans at a discount. As of the end of August 1987, borrowers had prepaid Higher Education Facilities and College Housing loans with outstanding principal balances totaling $792 million out of the $2.6 billion in loans held by Education at the start of the borrower prepayment programs. The borrowers' loan prepayments received by Education totaled $499 million. Under the plan to sell these loans to the public, Education planned to receive about $589 million in net sale proceeds. Also, in discussions about our draft report, Education advised us that as of October 9, 1987, it had collected over $130 million by selling loans with outstanding unpaid principal balances of $237 million to third parties. Education commented that it still held 1,914 outstanding loans which included 150 loans in default and that it planned to sell all loans, including those in default, by the end of fiscal year 1990.

Education also advised us that it is working with its private financial adviser to prepare the files for the Higher Education Facilities and College Housing loans that have not been prepaid by borrowers for sale to the public. Education stated that because of the results of its borrower prepayment program, use of a sampling methodology for rating the loans, and in-house work already performed to prepare the loan files, final costs to dispose of the Higher Education Facilities and College Housing loan portfolios will be a fraction of the $75 million in loan preparation costs estimated by its consultant. Education has incurred about $385,000 in costs to sell $237 million in loans to the public. The sale of the remaining loans held by Education, which could involve as much as $1.5 billion, will require Education to update loan documentation and obtain credit ratings for the loans. A reliable figure for the actual costs to prepare these loans for sale will be known if and when the sales are consummated. The preparation costs will be higher than if Education maintained adequate and updated documentation of its loan portfolio.

Lack of Accountability and Control Over Personal Property

Education's personal property includes computer equipment, office equipment such as typewriters and calculators, and specially designed electronic equipment such as video recording equipment and video monitors. Much of the property Education owns, or has a financial interest in, is held and used by contractors and grantees.

Education lacks adequate accountability and internal control over expensive personal property. We found that Education does not operate suitable accounting systems for personal property and, as a result, Education does not know where all the Department's property is located, its value, and how it is used. Consequently, managers do not know the total dollar value of the property owned by Education and have no means of safeguarding these assets from fraud, waste, and mismanagement.

Education's Personal Property Management and Property Inventory systems were designed to account for, control, and report on the Department's entire investment in government equipment, which is referred to as personal property. These systems include records of property (except for automated data processing (ADP) property), based on an October 1986 inventory, that Education holds and uses in its Washington, D.C., headquarters. The systems were also designed to account for certain government-owned property in the possession of contractors, but Education officials told us that the 150 records pertaining to contractor-held property are incomplete. In addition, the information is incomplete in the systems pertaining to ADP equipment, property in Education's 10 regional offices, and property in the possession of grantees in which the government has a financial interest.

Our review showed that Education lacks accountability for and control over government-owned property held and used by its contractors. For example, Education's records showed one contractor with property valued at $8,900; however, the contractor's financial records, which were audited independently by a public accounting firm, reported about $4.1 million in government-owned property. Our visits to other contractors found similar disparities between Education's records and the amount of property that contractors held and used. We visited one contractor who had held for 6 months two checks totaling $2,000 from the proceeds of the sale of government property. A portion of the proceeds should have been turned over to the government based on its original share of the cost of the property. The contractor explained that the checks were held pending the completion of a financial audit by a public accounting firm.

Also, contrary to Education's contract requirements, the contractors we visited did not label government-owned property in their possession as government property, and property records did not identify government property. Instead, the property we examined was labeled as contractor-owned, and the contractors' property records did not distinguish government-owned property from contractor-owned property. Education acted in 1986 to improve its accountability over personal property and, for example, it inventoried property in its Washington, D.C., headquarters. However, property in the hands of contractors may be subject to greater risks than that at Education's headquarters and no effort has been made to improve accountability and controls over this property.

The Department's Inspector General has also pointed to problems with personal property management at Education. A December 1984 IG report to the Deputy Under Secretary for Management pointed out that Education did not account for its share of property being acquired by grantees with federal funds and that overall personal property management was ineffective. Another IG report, issued in May 1985, reported the omission of $21 million of equipment from government records of government-owned equipment being used by contractors. In July 1985, the IG reported that at one storage facility for typewriters, calculators, and other equipment, there were no inventory records and no records showing that items had been added or taken from available stock.

In addition, Education's December 1986 FMFIA report to the President and the Congress stated that its accounting systems for personal property did not conform to the Comptroller General's accounting principles and standards. Specifically, the report stated that Education did not adequately account for ADP equipment, property in its regional offices, and contractor-held property.

In discussions about our draft report, Education advised us that it has recently entered into a cross-servicing agreement with the Department of Agriculture to use its Personal Property Accounting System for property used within Education. Education's decision to use the Department of Agriculture's Personal Property Accounting System is a step in the right direction towards establishing accountability and control over personal property used within Education. Whether the use of this system will actually impose effective accountability for and control over personal property used within Education cannot be determined until after the new system has been implemented and is operational.

With respect to contractor-held property, Education acknowledged that it is responsible for maintaining accounting control over this property and advised us that it is implementing a new Contracts and Grants Management System which, in conjunction with the Department of Agriculture's Personal Property Accounting System, should track and control all property held by contractors. Implementing these systems will be a major undertaking because millions of dollars of property in the hands of contractors will have to be identified and recorded in the new system. This property has not been recorded previously by Education. Whether these system initiatives will actually solve Education's personal property accounting system problems cannot be determined until after the new systems have been implemented and are operating.

With regard to grantee-held property, title to property purchased under a grant vests with the grantee but the property is subject to government disposition requirements. For example, the government can direct the grantee to make the property available to another government grantee, or if the grantee sells the property, the government shares in the net sales proceeds in proportion to the government's share of the purchase price of the property. Education officials commented that they do not believe that the Department has a legal requirement to maintain accountability for grantee-held property. We believe that Education should maintain summary financial and accountability control for the government's financial interest in grantee-held property.

Weak Controls Over Pell Grant Program Result in Erroneous Payments and Impede Collection of Overpayments

Education, through its Pell Grant Application Processing System, determines students' eligibility to participate in the program based on student- and school-supplied eligibility information. In addition, Education's Pell Grant Regular Disbursement System (1) advances funds to postsecondary education institutions based on historic program costs and (2) reimburses institutions for administrative costs based on the schools' expenditure reports. The Department relies primarily on subsidiary accounting systems run by postsecondary education institutions to authorize, compute, and disburse payments to students under its financial aid programs. It is the schools' responsibility to ensure that payments are made to eligible students in proper amounts. Consequently, Education relies on subsidiary accounting systems operated by postsecondary education institutions to ensure the propriety of Pell Grant payments to individual students. Many of these systems include long-standing weaknesses which result in millions of dollars in erroneous student financial aid payments annually. In addition, the Pell Grant Disbursement System does not provide adequate internal accounting

controls to ensure that all grant overpayments are identified, recorded, and collected.

Education made about $2.9 billion in Pell Grant awards in fiscal year 1985 to 2.9 million students at about 7,600 participating postsecondary education institutions. Grant funds are disbursed primarily through the accounting systems run by each institution which has agreed to act as an agent for Education. In addition, Education itself disburses some funds through its Alternate Disbursement System.

Erroneous Pell Grant Payments

Education provides postsecondary education institutions with cash advances to make payments to students and reimburses the schools for administrative costs. The schools are required to establish and operate subsidiary accounting systems that authorize, compute, and issue student financial aid payments in accord with federal requirements when they act as representatives for Education in carrying out day-to-day provisions of student financial aid. These requirements mandate that these systems operate to reasonably ensure that financial aid payments are made only to eligible individuals in proper amounts. To do this, systems operated by the schools should ensure that, among other things, student-supplied eligibility information is accurate and complete, financial aid payments are computed in accord with Education's requirements, and financial aid funds are used only for authorized purposes.

Required biennial audits of school operations are a primary means by which Education ensures compliance with Pell Grant Program requirements. About 3,700 of these audits are done each year by Education's IG, state auditors, and independent public accountants who provide their audit reports to the IG. Biennial audits of school program and accounting operations repeatedly disclose weaknesses in these operations that have resulted in hundreds of millions of dollars in erroneous payments to students and misuse of funds by the schools.

We analyzed audit results of school operations that covered the Pell Grant Program for the period October 1983 through June 1986. These audit results covered 326 postsecondary educational institutions and revealed more than 3,400 erroneous payments and accounting deficiencies. The erroneous payments included improper payments to students and improper use of funds by schools and students. As a result of these audits, the Department collected almost $11.2 million from the schools. Overall, audits of school operations resulted in millions of dollars of disallowed and questioned costs. For example, the IG reported that the

1,644 reviews completed by various audit groups during the 6-month period ended September 30, 1986, recommended disallowance of costs totaling about $42.7 million and questioned additional costs totaling about $21.7 million. Of these amounts, Education collected about $15.1 million from schools during this same period.

Our analysis of the results of IG and public accounting firm audits of school operations reported during fiscal years 1984 through 1986 showed the following continuing problem areas:

- excess balances of federal cash advances being held by schools,
- awards of student financial aid to ineligible students by schools,
- claims for reimbursement for costs improperly classified by schools and administrative costs for student financial aid programs, and
- inadequate school accounting systems for day-to-day operations of student financial aid programs.

For example, audit reports issued by a public accounting firm in November 1980, October 1981, and October 1985 covering one school's operations repeatedly reported the same accounting system deficiencies. Specifically, the reports pointed out that the school

- did not use its accounting system to monitor balances of advanced federal cash resulting in excessive balances of cash advances,
- did not reconcile student financial aid payment information recorded in its accounting and program administrative records with the result that payment errors went undetected, and
- did not include information in its accounting records to substantiate that students actually received awarded financial aid payments.

All three audit reports recommended that the school (1) use its accounting system to monitor cash balances, (2) reconcile its accounting and administrative records, and (3) expand its accounting records to substantiate that students actually received financial aid payments.

Education will not know whether a school has actually implemented nonmonetary audit recommendations related to financial management until the next biennial audit of school operations is completed. Education, as discussed in chapter 3, does not have an audit tracking system that provides assurance that financial management audit recommendations are implemented by the schools. Consequently, Education must wait at least 2 years to determine whether financial management system audit recommendations have been implemented.

In a September 1985 report[2], we stated that Education's actions to reduce postsecondary education institution errors in financial assistance awards to students were not effective and pointed out that erroneous grant awards totaled about $600 million over a 2-year period.

In discussions on a draft of this report, Education advised us that the biennial audits are a valuable means for ensuring school compliance with Pell Grant Program requirements and that implementation of pledged corrective actions for prior audit findings is verified by Education's Office of Postsecondary Education when it conducts program reviews at schools. Education also advised us that, subsequent to our review, it has instituted a program of monetary fines to penalize schools with repeated failures to implement pledged corrective actions for audit findings. The effectiveness of Education's new system of monetary fines to encourage schools to promptly implement pledged corrective action for audit findings will have to be assessed after the system is in place and operating for a reasonable period of time.

Collection of Pell Grant Overpayments Impeded

Education's accounting systems for the Pell Grant Program do not record and report information needed by managers to (1) preclude awarding more money to a student who is already indebted to the program for a previous overpayment, (2) monitor Pell Grant accounts receivable from students who lose their eligibility, and (3) collect accounts due to the greatest extent possible. For example, under the disbursement systems run by the schools, if students do not complete the course work for which grants were awarded, the schools set up detailed accounts receivable records and try to collect the amounts owed. Consequently, Education believes that it does not need to record accounts receivable by individual student.

However, because Education does not record accounts receivable by student, students who incur a debt at one school can transfer to another without repaying the debt, apply for Pell Grants at the second school, and receive the grants. The Department does not have any accounting control over Pell Grant Program accounts receivable and consequently cannot ensure that Pell Grants are not awarded to students who are indebted to the program. The Department only records accounts receivable by individual student when schools have abandoned collection

[2]Pell Grant Validation Imposes Some Costs and Does Not Greatly Reduce Award Errors: New Strategies Needed (GAO/PEMD-85-10, September 27, 1985).

efforts and have turned over the accounts to the Department for collection.

Another example of Pell Grant internal control deficiencies is that under the disbursement system managed by the Department, both the student and the school are "on their honor" to notify the Department if the student does not finish the courses for which a grant had been awarded. The Department has no other method for learning whether students who were awarded grants completed their courses or whether they dropped from school and thus must repay some or all of the amounts they were granted.

Education's December 1986 report to the President and the Congress under section 4 of FMFIA acknowledged that it does not have adequate control over Pell Grant accounts receivable. Specifically, the report stated that its Pell Grant accounting systems do not record and track accounts receivable due from grant recipients.

In discussions about our draft report, Education advised us that before the Education Amendments of 1986 became law, if a student was overpaid Pell Grant funds at one school, he or she was only precluded from receiving further Pell Grant funds at that school. The Education Amendments of 1986, however, preclude students from receiving Pell Grant funds at any school if they were overpaid Pell Grant funds at any other school. Subsequent to our review, Education issued regulations which prohibit all schools from making Pell Grant payments to students who have received overpayments of Pell Grant funds at any and all institutions previously attended. For transfer students, schools are required to provide certified financial transcripts to the school to which a student is transferring. In addition, knowingly making a false certification of student course transcripts, which are used in conjunction with the financial aid transcripts to identify Pell overpayments, is subject to a fine of $10,000, imprisonment for up to 5 years, or both. The effectiveness of financial transcripts and criminal sanctions for false course transcripts in reducing unpaid Pell Grant overpayments will have to be determined after these new systems have been in place for a reasonable period of time.

Contract and Grant Accounting Systems Do Not Support Management Needs

The accounting systems for discretionary grants and contracts awards do not provide managers with the information needed to manage, control, and report on the more than $1 billion in contract and grant awards made each year. More specifically, the system cannot provide managers with the information needed to determine whether or not to award specific contracts and grants and to respond to information requests from inside and outside Education on contract and grant awards made. As a result, additional costs are incurred to manually prepare required reports.

Education awards two types of grants—formula and discretionary—and also awards contracts. For formula grants, Education must, by law, award the grants if a grant application is received from an entitled organization. Further, the amount of the grant award must be based on a formula included in the law that authorizes the grant program. For discretionary grant programs, Education has the authority to evaluate and accept or reject a grant application. If Education elects to award a discretionary grant, it establishes the grant amount through negotiations with the grant applicant. Similarly, Education has discretion in approving contract applications, and it negotiates contract amounts with the applicants. Since 1979, Education has awarded an average of about $1 billion annually in discretionary grants, about $175 million annually in contracts, and about $8 billion annually in formula grants.

Responsibility for issuing contracts and grants is shared among Education's principal operating components (POCs) and the Office of Contracts and Grants. The POCs receive and review contract and discretionary grant applications, select the contracts and grants to be awarded, and set technical requirements and monetary negotiating targets for selected contracts and discretionary grants. The Office of Contracts and Grants, as an agent for the POCs, negotiates contracts and discretionary grants with applicants, awards the contracts and grants, maintains detailed contract and discretionary grant accounting records, and reports summary financial information on contract and grant awards to Education's general ledger system.

A 1985 review of system operations by a consultant engaged by Education disclosed that its contract and grant accounting systems are slow and record and report inaccurate information. As a result, financial reports produced by the systems must be manually reviewed to identify

and correct errors before the reports can be used. In addition, the consultant reported that certain reports the system was designed to produce cannot be prepared by the system because of operating problems. As a result, these reports must be manually prepared.

Specifically, the consultant reported that the system cannot respond to routine requests for information. For example, the system could not provide information requested by the Secretary of Education on contracts and grants that had been awarded to fund certain types of education projects. The needed information was obtained by simply asking contract and grant personnel if they remembered whether such projects had been funded. In another instance, a congressional request for a list of education research contract and grant awards could not be satisfied by the system. The list had to be manually prepared—a job which took 2 weeks to accomplish. In a third case, the system could not produce lists of contracts and grants awarded for education technology projects which were needed to develop future expenditure plans. The lists were manually prepared for a period of several months on two separate occasions.

Education's December 1983 report to the President and the Congress under section 4 of FMFIA acknowledged that its system for contracts and grants cannot meet managers' information needs. The report stated that the systems used by the Office of Contracts and Grants were inadequate and could not respond to managers' changing information needs.

In commenting on a draft of this report, Education advised us that it has designed a new contracts and grants accounting system and plans to implement this system during fiscal year 1988. Education believes that the new system will provide more flexibility and responsiveness than the current system. We believe that the new system is a step in the right direction. Whether this system will actually solve Education's problems with its current contracts and grants system will have to be determined after the new system has been implemented and is operational.

General Ledger System Cannot Produce Auditable Financial Statements

Education's statements of financial condition—the principal financial reports of a federal agency—do not flow from and are not supported by its accounting system (its general ledger and supporting subsidiary accounting systems) as required by the Comptroller General's accounting principles and standards. As a result, Education officials cannot attest to the reliability of the information in the general ledger system

and its supporting accounting systems. In our review, we found the following problems with the general ledger system.

- The general ledger system cannot accept much of the transaction information from the subsidiary accounting system for the Department's $2.6 billion Higher Education Facilities and College Housing Loan programs due to the incompatibility of the systems.
- The general ledger account for personal property was not supported by its subsidiary accounting systems for personal property. Specifically, our review showed that as of September 30, 1985, the general ledger reported personal property of $27 million held and used by Department contractors, while the subsidiary accounting system records for personal property held and used by Department contractors reported $46 million. In addition, for personal property used within the Department, subsidiary records were incomplete and could not be reviewed.
- The Department continues to have problems in preparing reliable financial reports on accounts and loans receivable due from the public. Specifically, a recent GAO report[3] stated that the Department's general ledger system does not record information on receivables such as collections, accrued interest, and insurance premiums.

The Comptroller General's principles and standards, as published in GAO's Policy and Procedures Manual for Guidance of Federal Agencies, specify that agency financial statements shall result from an accounting and budgeting system that is an integral part of its total financial management system and one that contains sufficient discipline, effective internal controls, and reliable data. These principles and standards provide that agency financial statements include comparative financial data from the immediate prior year, if applicable, and that data from both years be reported in a consistent format.

An accounting system which complies with these standards comprises a number of interrelated component subsidiary systems. These include a general ledger system and a number of other financial systems that account for and control specific assets and liabilities and authorize the use of, account for, and control the agency's appropriated funds and other resources. Taken as a whole, the accounting system authorizes, records, classifies, and reports financial data related to revenues, expenses, assets, liabilities, and government equity.

[3]Debt Collection: Billions Are Owed While Collection and Accounting Problems Are Unresolved (GAO/AFMD-86-39, May 23, 1986).

The general ledger system should maintain summary information for all financial resources, administratively control appropriated funds, and produce summary financial reports which should provide the necessary information for preparing statements of financial condition. The general ledger system should draw information from the financial systems that authorize, record, process, and report individual financial transactions. Consequently, the information presented in an agency's general ledger and other subsidiary financial systems should be traceable to its statements of financial condition.

As far back as December 1984, Education's reports to the President and the Congress pursuant to FMFIA acknowledged that a major weakness in its accounting system was the inability of its general ledger system to accept and record information from its subsidiary accounting systems. As a result, the information in the general ledger cannot be reconciled with and substantiated by information in subsidiary systems. The Department also reported this weakness in its December 1985 and 1986 FMFIA reports. For example, in December 1986 Education reported that its general ledger system

- could not accept and record all relevant payroll expenses and liabilities, such as accumulated leave, from its subsidiary payroll accounting system;
- did not reconcile with its subsidiary accounting system for receivables which accounts for and controls about $10 billion in receivables;
- did not reconcile with its subsidiary accounting system interest payments made to private lending institutions which total about $2.4 billion a year under the Guaranteed Student Loan program; and
- cash balances did not agree with cash balances for the Department as recorded in Treasury's accounting system. (These two balances should agree.)

The inability of Education's general ledger system to accept all transaction information from its subsidiary accounting systems and to be reconciled with these systems has resulted in managers relying on estimates and records other than the general ledger to prepare the annual statements. Education officials told us that none of the information in Education's statement of financial condition is drawn from the general ledger.

The Department of the Treasury publishes, in its "Bulletin" for the first quarter of each fiscal year, statements of financial condition and detailed supporting schedules for all federal agencies. The statements present the status of agencies' appropriated funds, assets (such as

accounts receivable), liabilities (such as accounts payable), and government equity (such as investments of the U.S. government). The "Bulletin" also includes detailed supporting schedules of accounts and loans receivable. Each agency furnishes Treasury with the data that is published. Our current review confirmed that the information on Education's September 30, 1985, statement of financial condition submitted to Treasury did not flow from and was not supported by its general ledger.

Education advised us that it has been aware of weaknesses in its accounting system and has already taken action to improve the situation. Specifically, Education has implemented a new payment system which should improve the reliability of payment information flowing into its general ledger. Education has also modified the magnetic tape it receives from the Federal Reserve Bank in Richmond, Virginia, so that information on the Higher Education Facilities and College Housing loan programs can be entered into the general ledger. Other systems that feed information into the general ledger are also being reviewed and revised. Education also advised us that it is reconciling its current general ledger records with Treasury records and source documentation. In addition to these initiatives, Education has a project underway to replace its current general ledger system.

Agency Comments and Our Evaluation

In written comments and discussions on a draft of this report, Education provided updated information on the results of loan prepayment activity, further explanation of the costs associated with selling other outstanding loans, and actions taken to improve accountability over personal property and to correct weaknesses in its accounting system. We included this information in the appropriate sections of this chapter. (See appendix II for Education's specific comments.)

Causes of Weaknesses in Education's Accounting Systems Known but Remain Uncorrected

Education's financial management problems are generally known and acknowledged by its managers. Their efforts to correct these problems, however, need to be improved. Specifically, action needs to be taken by top managers to more effectively communicate their emphasis on and expectations for implementing financial management improvements. Also, Education's ADP planning process—particularly for major financial management system projects—needs to be strengthened to provide information needed to ensure that projects are funded and implemented on a priority basis. Finally, better follow-up is needed of contractor and grantee actions taken in response to audit findings and recommendations to ensure that promised corrective actions relating to accounting and internal control systems are actually implemented.

Education's Annual Plans Do Not Give Adequate Priority to Financial Management Problems

Education continues to experience problems in articulating top managers' emphasis on and expectations for implementing financial management improvements. A private management consultant pointed out this problem in a report in 1978 (when Education was part of the Department of Health, Education, and Welfare) and in another report in 1983. The consultant reported that Education's combined planning and budget formulation process did not clearly articulate top managers' goals, objectives, and priorities and that, as a result, Education had not acted to correct known problems, including financial management system deficiencies.

Currently, the Secretary's annual goals and priorities statement is used to communicate goals, objectives, and priorities to operating managers. This statement initiates Education's annual planning and budget formulation effort which includes developing the ADP plan and budget request. The Secretary's annual goals and performance priorities statements, however, focus on specific program goals and priorities but only generally discuss goals and priorities for financial management improvements—particularly internal department financial management improvements. These problems are discussed in general terms under headings such as debt collection and management improvements, but are not translated into detailed short- and long-range action plans specifying objectives, priorities, and timetables for achieving them.

In addition, the Secretary's statements omit certain problems. For example, the Secretary's goals and priorities statements for 1983 through 1986 did not focus on the need to improve the Department's accountability for and control over personal property even though these problems have been reported by the IG since at least July 1984 and have been

acknowledged by the Department in its 1984 to 1986 reports to the President and the Congress under FMFIA.

Our analysis of the 1983, 1984, and 1986 statements (a statement was not issued for 1985) showed that for fiscal years 1983 and 1984, the goals for management improvements focused on the operations of contractors and grantees but did not address known problems with Education's internal financial management operations. In contrast, the fiscal year 1986 statement included a financial management goal and performance priority for Department management improvements focusing on internal operations to ensure that responsibilities are carried out as effectively and as efficiently as possible. The 1986 statement called for a separate effort to ensure that internal management improvements would be initiated. Thus, the Deputy Under Secretary for Management requested that the heads of all the Department's organizational components provide written comments on the Department's internal management problems and potential corrective actions. The Deputy Under Secretary received the requested written comments early in calendar year 1986. The written comments covered financial management, administrative, and program issues; however, specific short- and long-term action plans have not yet been developed based on the comments received.

The private consultant recognized that Education's top management needed to establish specific goals and objectives for program and financial management improvements. Consequently, in 1978 and 1983 reports, the consultant recommended that Education's planning and budget formulation approaches be improved to more clearly establish program and financial management goals, objectives, and priorities; communicate goals, objectives, and priorities to managers; develop and implement action plans; and assess the implementation of action plans. The consultant reported in 1978 and 1983 that (1) the Secretary's priorities are personal and not the result of a systematic review of agency needs leading to institutionally derived priorities and (2) communication in the agency depends substantially on informal meetings from which results are not adequately documented and transmitted to affected parties.

In response to the consultant's 1983 report, Education initiated a strategic planning process to prepare departmentwide short- and long-range goals. However, the 2- to 3-year timetable set for implementing the strategic planning process was not followed. The process was not reinitiated after 1983, and the planned principal product of strategic planning, the

planning and fiscal guidance memorandum for fiscal years 1983 to 1987, was never issued. Prior to fiscal year 1987, Education's only departmentwide short- and long-range plan was its ADP plan which included system designs and improvement projects for financial management systems as well as other ADP projects.

In discussions on a draft of this report, Education advised us that it prepared and submitted a 5-year financial management improvement plan with its fiscal year 1987 budget request pursuant to Office of Management and Budget (OMB) circular A-127, "Financial Management Systems." The plan presented detailed short- and long-range action plans for financial management systems specifying objectives, priorities, and timetables for achieving them. We agree that the Department's financial management improvement plans in response to OMB circular A-127, prepared for the first time after our audit work was completed, will provide the needed details on financial management system improvement projects not presented in the Secretary's annual goals and performance priorities statements.

Automated Data Processing Improvement Plans

Education's ADP improvement plans are prepared and updated annually to support its budget request for ADP which is included in Education's part of the President's annual budget request. The plans include projects for accounting systems design and improvement projects for systems operated by Education, and other ADP-related projects such as the acquisition of electronic mail systems and word processing equipment. The ADP plans, however, do not fully describe all projects, show milestone dates for all projects, or present the relative priority of projects. Also, the rationale supporting decisions to fund certain projects and not to fund other projects is not documented. As a result, Education's ADP planning process and resulting ADP plans cannot be evaluated to determine whether ADP projects—particularly projects for accounting system redesign—are funded in priority order.

The Department uses a three-track process to develop its annual plans and budget request. One track produces the Department's program plans and related budget request, another produces the budget request for salaries and expenses, and a third track develops the ADP plan and related budget request. After the three individual budget requests are finalized, they are combined into a departmentwide request that is submitted to the Office of Management and Budget, the President, and ultimately the Congress.

We reviewed Education's ADP plan and related budget request dated November 18, 1985, which showed fiscal year 1985 actual ADP expenditures and fiscal years 1986 and 1987 budget requests and included funding for projects that are already underway and proposed new initiatives. We found that the ADP plan and budget request

- included financial management information systems and other ADP-related projects (such as procurement of ADP equipment and telecommunications services) as well as projects which should have been budgeted separately such as special consultant studies of education issues that use ADP resources to compile and report study information,
- included 284 projects for which funds were requested for fiscal years 1986 and 1987 and 128 inactive projects for which no resources were requested (89 of the latter did not list reasons for not requesting funds),
- presented all ADP projects proposed by POCs but not in a priority order,
- presented 80 project titles but did not present descriptions of the work to be done under these projects, and
- did not present work milestone dates for 153 of the 412 projects included in the budget request.

For fiscal year 1986, Education received $46.1 million of the $64.8 million requested in ADP resources in its November 1985 ADP plan and budget request, and consequently, it postponed and did not fund for fiscal year 1986, 70 of its 284 projects originally planned and budgeted for fiscal year 1986. Top management personnel who made the decisions to postpone and not fund certain ADP projects for fiscal year 1986 told us that their decisions were based on discussions with selected Information Resource Management Service and POC senior officials and managers. These discussions and the rationale for decisions, however, were not documented.

We were told by Education officials that the relative priority of the 284 ADP projects in the fiscal year 1986 ADP plan was not established in the ADP plan and budget request and the projects were not reprioritized as a basis for deciding which ones to postpone. Instead, discussions focused on the high-dollar value projects and many of the lower-dollar value projects were not discussed.

For fiscal year 1986, Education postponed certain ADP projects that were designed to address known accounting system issues and retained 24 ADP projects not related to known accounting system problems. Some examples follow.

- The long-range accounting system study designed to identify the Department's long-range accounting system needs was postponed.
- The Integrated Student Aid Delivery System project was postponed even though it was designed to correct longstanding weaknesses in the Department's student financial aid accounting systems—including the Pell Grant and National Direct Student Loan programs' systems. The Department's 1985 ADP plan pointed out that, over a number of years, the Department has received many audit reports that identified serious deficiencies in the accounting systems supporting these programs which resulted in poor debt management, ineffective cash management, absence of needed internal controls, inadequate information, and the inability of the Department to ensure schools' adherence to the Department's policies, procedures, and regulations.
- The Offerings and Enrollment Analysis Project was retained to study trends of postsecondary school course offerings and enrollments in order to develop a universal postsecondary course classification system.

Education's decision to postpone and retain certain ADP projects for fiscal year 1986 could not be effectively evaluated to determine whether the highest priority projects were retained and funded because (1) the ADP plan and budget request did not present full descriptions of the work to be done under all planned projects and show the relative priority of planned projects, (2) projects were not ranked during the decision-making process, and (3) discussions and decisions that resulted in postponing 70 projects for fiscal year 1986 were not documented. Overall, the documentation for Education's ADP plan and budget request and the funding decisions taken relative to ADP projects do not support an effective, independent evaluation by Education's top mangers of these decisions to determine whether projects are funded in a priority order.

In discussions on our draft report, Education officials advised us that beginning with the fiscal year 1987 annual ADP improvement plans, these plans include detailed goals, objectives, purpose, and projected benefits of each project as well as the relative priority of each project. In addition, a new project tracking system was instituted in fiscal year 1987 to establish and track all key milestone dates for each ADP improvement project. We believe that these actions should correct the weaknesses in Education's ADP plans.

Inadequate Follow-up on Contractor and Grantee Audits

Education does not have adequate procedures and systems in place to ensure that system deficiencies in contractor and grantee accounting systems are corrected promptly. These systems disburse billions of dollars in Education's funds. Specifically, Education does not have adequate audit resolution systems to document follow-up and corrective actions for nonmonetary findings and recommendations relating to the accounting, program, and administrative systems and operations of all contractors and grantees that act as representatives for Education in carrying out day-to-day operations of Education's programs. As discussed in chapter 2, audits of school operations disclose the same accounting system weaknesses in successive audits. These deficiencies have resulted in the improper disbursement of hundreds of millions of dollars.

As discussed in chapter 1, Education depends on the accounting systems and related procedures of schools—particularly postsecondary education institutions—to ensure that about $9 billion in annual student financial aid payments are properly made. It relies on biennial audits of the operations of these systems and procedures to disclose problems and initiate corrective actions. Weaknesses in Education's audit follow-up systems do not provide the information managers need to ensure that schools actually implement pledged corrective actions.

From fiscal years 1983 through 1985, about 600 audits and evaluations of Department internal operations were completed and more than 10,900 audits and evaluations of school operations were completed.[4] The Department documents all audit recommendations involving the recovery of moneys, and the Department uses this documentation to track the actual funds recovered related to each audit recommendation involving the recovery of moneys to ensure that the appropriate amount is actually collected.

We tested the audit follow-up activities of the Office of Postsecondary Education, whose contractors and grantees—postsecondary education institutions—disburse about $2.9 billion in Pell Grant awards. As discussed in chapter 2, these institutions made about $600 million in erroneous grant awards during a 2-year period. The Office of Postsecondary Education operates an automated audit and evaluation tracking system

[4]The audits and evaluations include GAO reviews, IG reviews, Federal Managers' Financial Integrity Act annual reviews, consultant studies and reviews of Department contractors and grantees (including colleges and universities), and special evaluations required by statute.

for reviews of school operations. However, because of computer programming problems, this system cannot produce needed reports on audit and evaluation findings and recommendations and on schools' corrective actions. The Office of Postsecondary Education has retained a private consultant who is currently working to correct the programming problems in the system.

The Office of Postsecondary Education produced a special printout for our review of its automated system of tracking audit results. This printout is not produced in routine circumstances. We reviewed audit results included in the Office of Postsecondary Education's automated tracking system for audit reports issued from September 1983 through June 1986 that covered reviews of the operations of 326 contractors and grantees and made more than 3,400 recommendations. About 2,400 recommendations involved the recovery of moneys which were tracked by the IG. The remaining 1,000 recommendations involved financial management improvements to school operations such as the upgrading of one school's accounting system to identify administrative costs related to Education programs which are reimbursed to the school by Education.

The Office of Postsecondary Education, however, did not document whether pledged contractor actions designed to respond to these 1,000 recommendations were actually implemented. Office officials told us that for nonmonetary—financial management system—findings, once the school pledges a corrective action that is considered responsive to a particular audit recommendation, the audit recommendation is considered closed. Future audits of the same school are relied upon to determine whether the pledged corrective actions are actually implemented. Consequently, as discussed in chapter 2, successive audits of school operations disclose the same financial management findings year after year.

In an August 1985 memorandum to the Deputy Under Secretary for Management, the IG reported that Education's approaches and systems for audit and evaluation tracking and follow-up are diffused throughout the Department's POCs without any internal controls to ensure that all corrective actions have been implemented or that the status of corrective actions is adequately documented and reported. In addition, the IG reported that only two POCs have audit tracking and follow-up systems and updated, written follow-up policies and procedures. The IG recommended that Education implement a departmentwide audit follow-up tracking and reporting system to provide reasonable assurance that all

reviews—of internal department operations as well as contractor and grantee operations—are promptly followed up and that adequate documentation is maintained showing that promised corrective actions are actually implemented.

Education's December 1986 FMFIA report stated that it was developing an automated tracking and reporting system for GAO and IG audits which will be integrated with Education's system for tracking weaknesses and corrective actions related to the FMFIA reviews. These actions will not address the just-discussed tracking of recommendations to schools.

In commenting on a draft of this report, Education advised us that all its organizational components with audit resolution activities have submitted updated, written procedures for follow-up on audit findings and recommendations. In addition, the Office of Postsecondary Education has taken steps to re-emphasize existing audit follow-up procedures for nonmonetary audit findings. Also, the Department is proposing a system of fines for schools that do not implement corrective actions in response to audit findings in a timely manner.

The publication of updated, written audit follow-up procedures is a positive step, but it does not address all of the audit follow-up problems discussed. Specifically, the publication of follow-up procedures does not address the problem of only two of Education's six POCs having audit tracking and follow-up systems to record and report findings, pledged corrective actions, and implemented corrective actions. We believe that all POCs need to design and implement information systems to document audit follow-up activities. This documentation is needed to ensure that audit follow-up procedures are followed. The new system of fines should help ensure that schools implement corrective actions for audit findings in a more timely manner. The effectiveness of fines, however, will have to be evaluated after the system has been in operation for a reasonable period of time.

Agency Comments and Our Evaluation

Education advised us that it has taken actions to revise its audit follow-up procedures and we have updated that section of the chapter accordingly. However, additional action is needed to ensure that all POCs implement audit tracking and follow-up systems. (See appendix II for Education's detailed comments.)

Chapter 4

Conclusions and Recommendations

Conclusions

Overall, the Department of Education's accounting system does not provide managers with the reliable information they need to protect financial resources from fraud, waste, and mismanagement and to satisfy internal and external financial reporting requirements. The direct causes of these problems are the inadequate accounting systems for certain financial resources and the perpetuation of contractor and grantee accounting system problems. The accounting system problems and their causes have been pointed out by prior audits and evaluations and are generally acknowledged by Education officials.

Education has taken several initiatives to review and improve its current financial management systems. However, these projects focus on determining how to improve these systems rather than on evaluating and redefining the Department's accounting system needs and developing an overall financial management system design. We believe such a system design could serve as a master plan for designing and implementing individual systems. Such an effort—the long-range accounting system study—was included in Education's fiscal year 1986 ADP plans but was deferred.

Education continues to experience known financial management problems because top managers have not established specific goals and objectives to correct these problems. Education's ADP plans do not facilitate the funding and implementation of projects in a priority order. Education does not ensure that its contractors and grantees actually implement pledged accounting system improvements. Education advised us that, beginning with its fiscal year 1987 budget submission, it prepared and submitted along with its budget request, a 5-year financial management improvement plan as required by OMB circular A-127, "Financial Management Systems." This plan presents specific objectives, priorities, and timetables for financial management system improvements and supports the Secretary's annual goals and priorities statement. Education also advised us that, beginning with fiscal year 1987, its annual ADP plans will present the relative priority of all ADP projects and that it plans to institute a tracking system to establish and track milestone dates for ADP projects.

Education, through its implementation of OMB circular A-127, has established short- and long-range financial management system improvement plans that include specific objectives, priorities, and timetables. These plans, however, did not result from a structured redefining of the Department's financial management system needs as was contemplated in the deferred long-range accounting system study. Education needs to

reevaluate its financial management system needs, as contemplated in its deferred long-range accounting system study, and to use the results of this study to support development of both its financial management system improvement plans submitted pursuant to OMB circular A-127 and its ADP system improvement plans.

The major financial management problems facing Education have generally been reported to top management through audits and evaluations of the Department's program and administrative operations. The Department's audit and evaluation follow-up procedures, ADP improvement plans, annual goals and performance priorities statements, and financial management system improvement plans in response to OMB circular A-127 are designed to address these problems. However, these efforts have not been structured and carried out to (1) ensure that planned corrective actions are actually implemented by contractors and grantees and (2) document that ADP projects address problems in a priority order. Education advised us that it has updated its written audit follow-up procedures but this action alone will not result in implementing systems to record and report findings, pledged corrective actions, and implemented corrective actions. Currently, only two of Education's six POCs have such systems in place. All POCs need to have effective systems in place to document audit findings and pledged and implemented corrective actions. Education also advised us that, beginning with its fiscal year 1987 ADP improvement plans, the relative priority of each improvement project is shown in the plans. We believe that Education still needs to strengthen its planning and budgetary process to document discussions and decisions regarding the funding of ADP projects based on relative priorities.

Agency Comments and Our Evaluation

In written comments and discussions on a draft of this report, Education advised us that it has actions underway to improve its departmentwide financial management system and that it has made these projects a major funding priority. Education also advised us that it has taken other actions directed at improving audit follow-up and its ADP planning and budgeting process. We included references to these actions in the appropriate sections of this chapter. (See appendix II for Education's specific comments.)

We have dropped our proposed suggestion that the Secretary include specific financial management system improvement projects in the Secretary's annual goals and priorities statement because this suggestion

has been implemented through Education's financial management system improvement plans which were first prepared in fiscal year 1987 in response to OMB circular A-127. We have also dropped our proposed suggestion that the relative priority of ADP improvement projects be included in Education's ADP plan because Education implemented this suggestion beginning with its fiscal year 1987 ADP plans.

Recommendations

We recommend that the Secretary of Education:

- develop an overall design for a departmentwide financial management system that (1) addresses known financial management problems including weaknesses in Education's audit resolution and tracking programs, (2) considers managers' short- and long-range financial information needs, (3) establishes specific objectives, goals, priorities, and milestone dates for component system projects that, when taken together, will implement the conceptual design, and (4) sets the overall goals and timetables to be used in the planning and budgeting system for the department's short- and long-range ADP improvement plans;
- develop and implement audit recommendation tracking and follow-up systems for nonmonetary recommendations for contractor and grantee operations that track the implementation of pledged corrective actions; and
- revise the Department's planning and budgeting system for ADP plans to document discussions and decisions regarding the funding of projects.

Financial Management Profile

The Department of Education was created by the Department of Education Organization Act approved October 17, 1979, with the first Secretary sworn in on December 6, 1979. It is a cabinet-level department which establishes policy for, administers, and coordinates most federal education programs.

Organizational Structure of the Department

The Department is headed by the Secretary of Education and is organized as follows:

- Office of the Secretary and Under Secretary of Education,
- ten staff offices,
- three departmentwide management offices,
- six principal operating components (POCs), and
- ten regional offices.

Office of Secretary and Under Secretary

The Secretary of Education is responsible for the overall direction, supervision, and coordination of all activities of the Department and is the principal adviser to the President on federal policies, programs, and activities related to education in the United States. The Under Secretary is responsible for assisting the Secretary in the overall direction, supervision, and coordination of all activities of the Department and serves as principal adviser to the Secretary on federal policies, programs, and activities related to education.

Staff Offices

The Secretary and Under Secretary are supported by 10 staff offices:

- Executive Assistant/Chief-of-Staff,
- Executive Secretary,
- Executive Assistant for Private Education,
- Special Counsel for Deregulation,
- Educational Appeals Board,
- Assistant Secretary for Civil Rights,
- Assistant Secretary for Legislation and Public Affairs,
- General Counsel,
- Director-Regional Liaison, and
- Inspector General.

These offices assist the Secretary and Under Secretary in developing overall policy and management guidance; exercising management oversight of programs; financial management and administrative operations;

and providing liaison services to the Congress, other federal agencies, educational institutions, professional organizations, and the public.

Departmentwide Management Offices

The Offices of Management; Planning, Budget and Evaluation; and Intergovernmental and Interagency Affairs are departmentwide management offices that assist the Secretary and Under Secretary by managing and overseeing day-to-day administrative and financial management operations.

Office of Management

The Office of the Deputy Under Secretary for Management is responsible for developing, implementing, administering, and managing the Department's management support programs. This includes administrative services, personnel administration and manpower management, labor management relations, management evaluations, procurement and contract services, property administration, systems analyses, data processing services, and interagency liaison of management regulations and standards.

The Offices of the Comptroller and the Administrator for Management Services are responsible for carrying out the Office of Management's responsibilities. The Office of the Comptroller (1) formulates, develops, and implements departmentwide financial management, ADP, contract and grant, administrative budget, and credit improvement programs and (2) conducts day-to-day ADP, accounting, and financial management operations. The Office of the Administrator for Management Services develops and implements the Department's policies and procedures on all aspects of personnel management, administrative resource management, management improvement, and training.

Office of Planning, Budget and Evaluation

The Office of the Deputy Under Secretary for Planning, Budget and Evaluation serves as principal adviser to the Secretary and Under Secretary on planning and budget matters. The Immediate Office of the Assistant Secretary (1) coordinates Department activities in the preparation of the departmental budget, program analysis, and planning activities and (2) ensures that Department policy and program planning appropriately reflect the results of these activities.

These services are provided through two subsidiary components: the Budget Service and the Planning and Evaluation Service. The Budget Service has lead responsibility for (1) developing and implementing

departmentwide systems and procedures for the Department's budget process, including review of budget submissions and related materials, (2) formulating the Department's budget policy, (3) presenting the Department's budget to the public and the Congress, (4) establishing and maintaining a departmentwide budget execution system, and (5) conducting program operations review and analysis, including the monitoring of budget and policy implementation and of management objectives. The Planning and Evaluation Service has lead responsibility for (1) planning activities of the Department, (2) developing and overseeing the Department's annual agenda of evaluation and policy analytic studies and analysis of federal, state, and local education policies and issues, (3) conducting evaluations of Department program operations and impact on participants, (4) providing technical expertise in formula development, modeling, forecasting, and trends analysis tasks, and (5) conducting analyses of cost/benefit and institutional effects of regulations.

Office of Intergovernmental and Interagency Affairs

The Office of the Deputy Under Secretary for Intergovernmental and Interagency Affairs is responsible for overall leadership in establishing and directing effective intergovernmental and interagency services for the Department. The office communicates with a wide variety of intergovernmental, interagency, and public advocacy groups and constituencies affected by Department policy, programs, and operations.

Principal Operating Components (POCs)

The Secretary and Under Secretary are also supported by the Department's six principal operating components. Five of the POCs are headed by assistant secretaries and the other is headed by a director.

Office of Postsecondary Education

The Assistant Secretary for Postsecondary Education formulates policy and directs and coordinates programs for assistance to postsecondary educational institutions and students pursuing a postsecondary education. Programs include assistance for the improvement and expansion of American educational resources for international studies and services, grants to improve instruction in crucial academic subjects, and construction assistance for academic facilities. Also included are programs of student financial assistance, including Basic Educational Opportunity Grants (Pell Grants), Supplemental Educational Opportunity Grants, Grants to States for State Student Incentives, National Direct Loans to Students in Institutions of Higher Education, Work-Study, Cooperative Education, and the Guaranteed Student Loan Program.

Office of Elementary and Secondary Education	The Assistant Secretary for Elementary and Secondary Education formulates policy for, directs, and coordinates the activities relating to preschool, elementary, and secondary education in the Department. Included are programs of grants to state educational agencies and local school districts for Indian and migrant education, programs of financial and technical assistance to school districts to meet special needs incident to the elimination of racial segregation and discrimination, and grants for the education of neglected and disadvantaged students.
Office of Vocational and Adult Education	The Assistant Secretary for Vocational and Adult Education administers programs of grants, contracts, and technical assistance for vocational and technical education, education professions development, community schools, and comprehensive employment and training. The office is also responsible for providing a unified approach to rural and rural family education through the coordination of programs within the Department.
Office of Bilingual Education and Minority Language Affairs	The Director of the Office of Bilingual Education and Minority Language Affairs ensures access to equal educational opportunity and improves the quality of programs for limited English proficiency and minority languages populations by providing support for programs, activities, and management initiatives that meet the special educational needs of those populations. The office also provides assistance for the development, adoption, and implementation of plans for the desegregation of public schools.
Office of Special Education and Rehabilitative Services	The Assistant Secretary for Special Education and Rehabilitative Services is responsible for (1) special education programs and services expressly designed to meet the needs of handicapped children and thus fully develop their potential and (2) comprehensive rehabilitation service programs specifically designed to reduce human dependency, to increase self-reliance, and to fully utilize the productive capabilities of all handicapped persons. Programs include support of (1) training for teachers and other professional personnel, (2) grants for research, (3) financial aid to help states initiate, expand, and improve their resources, and (4) media services and captioned films for the deaf.
Office of Educational Research and Improvement	The Assistant Secretary for Educational Research and Improvement administers educational research functions of the Department concerning development, demonstration, dissemination, and assessment. The

office also administers a wide variety of discretionary grant programs to maximize individual program impact on school improvement. Existing and newly legislated programs include, but are not limited to: Arts in Education, Women's Educational Equity, Basic Skills, Environmental Education, Consumers' Education, Teacher Centers, Metric Education, Alcohol and Drug Abuse Education, Teacher Corps, Health Education, Law-Related Education, Civic/Citizenship Education, Marine-Aquatic Education, and Library Resources.

Regional Offices

The Department has 10 regional offices located in Boston, New York, Philadelphia, Atlanta, Dallas, Chicago, Kansas City (Missouri), Denver, San Francisco, and Seattle. These offices are managed by the Secretary's regional representatives. Each regional office serves as a center for dissemination of information and provides technical assistance to state and local educational agencies and other institutions and individuals having an interest in federal education activities.

Financial Highlights—Fiscal Years 1985 to 1987

In fiscal year 1985, the Department received about $21 billion of which about $19.1 billion came from current budget authority and $1.9 billion from other sources. In fiscal year 1986, the Department also received about $21 billion of which about $18.5 billion came from current budget authority and $2.6 billion from other sources. In fiscal year 1987, the Department anticipated receiving about $19.2 billion of which $16.3 billion was expected to come from current budget authority and the $2.9 billion from other sources. (See table I.1)

In addition to managing these appropriated funds, the Department manages seven active and five defaulted loan accounts. Three of the active accounts service guaranteed loans and the other four service direct loans. In regard to the five defaulted loan accounts, all defaults from the three active guaranteed loan accounts have been combined into one defaulted guaranteed loan account. Each of the four active direct loan accounts has a corresponding default loan account.

Sources and Application of Funds—Fiscal Years 1985 to 1987

The following table summarizes the Department's requests for funds included in the President's annual budget request for fiscal years 1985 to 1987. It highlights estimated sources of funds and expected uses of these funds to support the Department's programs and departmental management.

Table I.1: Summary of the Department of Education's Fiscal Years 1985 to 1987 Budget Requests

Dollars in millions

	1985	1986	1987
Available funds			
Unobligated balance, beginning of year	$1,231.6	$1,989.9	$1,485.6
Funds appropriated	19,096.3	18,451.4	16,271.7
Other federal funds	135.0	87.7	87.0
Nonfederal funds	553.3	514.4	1,297.5
Total funds available	**$21,016.2**	**$21,043.4**	**$19,141.8**
Available funds used			
Grants to states and local educational agencies	$8,950.9	$9,261.0	$8,100.5
Student financial assistance	8,513.3	8,784.4	8,059.8
Education facilities financial assistance	619.6	676.0	369.6
Educational research	60.6	60.6	70.2
Special institutions	369.6	400.7	252.8
Departmental management	300.9	312.6	315.0
Total funds used	**$18,814.9**	**$19,495.3**	**$17,167.9**
Available funds not used			
Unobligated fund balance, end of year	$1,980.4	$1,485.6	$1,345.4
Unobligated balance, transfers net	134.9	20.0	0
Redemption debt	62.0	41.0	603.0
Unobligated balance that will lapse	24.0	1.5	0
Borrowing authority	0	0	25.5
Total funds not used	**$2,201.3**	**$1,548.1**	**$1,973.9**
Total funds available	**$21,016.2**	**$21,043.4**	**$19,141.8**

Source: Budget of the United States Government, 1985—Appendix.

The large estimated increase in revenues from nonfederal sources, for fiscal year 1987, resulted from the Department's proposal to sell about $2.1 billion of its higher education housing loan portfolio to the public during fiscal years 1987 and 1988. The Department has estimated that this sale will yield about $579 million in 1987.

Loan Accounts

The scope of the three loan accounts managed by the Department is explained here. The guaranteed loan accounts consist of (1) guaranteed student loans, (2) guaranteed student loans marketing obligations, and (3) direct student loans. The guaranteed student loan account covers guaranteed loans administered through intermediate guaranty agencies under contract with the Department. The guaranteed student loans marketing obligations account concerns federal guarantees of obligations

issued by the Student Loan Marketing Association, as authorized under the Education Amendment of 1980. The direct guaranteed student loan account covers loans made directly to students by the Department. The Department stopped making direct guaranteed student loans in July 1984.

In addition to managing guaranteed loan accounts, the Department also makes direct loans. These consist of (1) national direct student loans, (2) higher education direct loans, (3) higher education facilities loans, and (4) higher education housing loans. The national direct student loan account covers loans handled by participating institutions through revolving loan funds capitalized in part with federal contributions allocated among states by formula. The higher education direct loan account covers direct loans made under the Cuban and Law Enforcement Education Loan programs.

The higher education facilities loan account covers loans made to colleges and universities for construction or renovation of academic buildings. The higher education housing loan account covers loans made to colleges and universities for the construction or renovation of student housing facilities.

The following tables present a financial overview of the Department's direct and guarantee loan accounts as of October 1, 1985 and 1986. This information was based on estimated loan account balances presented in the President's fiscal year 1986 budget request. These amounts have not been audited.

Table I.2: Estimated Loan Account Balances for Direct Loans and Loan Guarantees for Which Principal and Interest Payments Are Current

Dollars in millions

	Beginning fiscal year 1985	Beginning fiscal year 1986
Guaranteed loan accounts		
Guaranteed student loans	$31,962.0	$36,383.0
Guaranteed student loans marketing obligations	5,000.0	5,000.0
Other guaranteed loans	2,464.6	3,017.0
Total	**$39,426.6**	**$44,400.0**
Direct loan accounts		
National direct student loans	4,974.2	5,076.3
Higher education direct loans	86.1	63.7
Higher education facilities loans	375.1	360.1
Higher education housing loans	2,675.5	2,314.1
Total	**8,110.9**	**7,814.2**
Total	**$47,537.5**	**$52,214.2**

Source: Budget of the United States Government, 1987—Appendix.

Table I.3: Estimated Loan Account Balances for Direct Loans and Loan Guarantees for Which Principal and Interest Payments Are Not Current

Dollars in millions

	Beginning fiscal year 1985	Beginning fiscal year 1986
Guaranteed loan accounts		
Guaranteed student loans	$2,374.6	$2,860.0
Direct loan accounts		
National direct student loans	1,135.1	1,185.3
Higher education direct loans	33.4	23.1
Higher education facilities loans	27.9	18.7
Higher education housing loans	105.6	88.8
Total	**1,302.0**	**1,315.9**
Total	**$3,676.6**	**$4,175.9**

Source: Budget of the United States Government, 1987—Appendix.

Statements of Financial Condition

The Department's estimated statements of financial condition, as reported in the U.S. Department of the Treasury's "Bulletins" for fiscal years 1982, 1984, and 1985 are presented in table I.4. The Department's statement of financial condition for fiscal year 1983 was not published in Treasury's "Bulletin" because the Department did not provide its statements to Treasury promptly. As discussed in chapter 2, the information for the Department, as published in Treasury's "Bulletin," does not flow from the Department's general ledger accounting system but is based on estimates and records other than the general ledger accounting system. The information, however, is presented to show the relative importance of the Department's assets, liabilities, and government equity.

Table I.4: Statements of Financial Condition for Fiscal Years 1982, 1984, and 1985 as Reported in Treasury's "Bulletin"

Dollars in millions

	Fiscal year 1985	Fiscal year 1984	Fiscal year 1982
Assets			
Fund balance with Treasury	$15,804.8	$13,618.6	$13,478.4
Accounts receivable:			
Government agencies	54.0	35.4	67.3
Public	262.2	538.4	344.7
Less: Allowance for doubtful accounts	(45.5)	(40.6)	(4.5)
Advances:			
Government agencies	511.5	133.5	64.8
Public	.5	3,526.1	25.7
Total current assets	**$16,587.5**	**$17,811.4**	**$13,976.4**
Loans receivables	11,068.9	5,515.3	12,749.2
Less: Allowance for doubtful loans	(2,524.9)	(1,609.2)	(1,062.5)
Structures	126.9	124.2	126.2
Equipment	59.3	55.8	64.2
Less: Allowance for depreciation	(37.4)	(37.3)	(57.1)
Other assets	600.7	614.7	514.2
Less: Allowances	(273.0)	(243.9)	(266.1)
Total Assets	**$25,608.0**	**$22,231.1**	**$26,044.5**
Liabilities			
Accounts payable	$3,157.7	$3,793.0	$4,102.4
Deposit fund liabilities	92.9	44.5	9.9
Unfunded liabilities	0	0	1,337.5
Accrued annual leave	15.8	25.5	.5
Debt issued	3,184.9	2,909.5	3,205.2
Total liabilities	**$6,451.3**	**$6,772.5**	**$8,655.5**
Government equity			
Unexpended budget authority	$12,760.5	$10,429.0	$9,691.6
Unfilled customer orders	(15.8)	(25.5)	(124.2)
Invested capital	1,485.6	1,493.6	7,794.5
Other equity	4,926.4	3,561.5	27.1
Total equity	**$19,156.7**	**$15,458.6**	**$17,389.0**
Total Liabilities and Equity	**$25,608.0**	**$22,231.1**	**$26,044.5**

Department's Accounting Systems

The Department operates 29 accounting systems to account for, control, and report on its appropriated funds and other resources. The following table lists the 29 systems and briefly describes the functions carried out by each. These 29 accounting systems are in consonance with the accounting system inventory included in the Department's December 1986 FMFIA report.

Table I.5: Accounting Systems

Name	Purpose
Financial Information Retrieval, Error Correction, and No Errors Data Entry System	Maintains the Department's official general ledger accounts, prepares summary financial reports, and provides summary financial controls for the Department's appropriated funds and other resources.
Education Department Payment Management System	Processes cash disbursements; is maintained by the Department of Health and Human Services.
Accounts Receivable System	Records and maintains detailed accounts receivable resulting from audits that disallowed contractor and grantee disbursements and amounts due from students under financial aid programs after collection efforts were abandoned by the educational institutions and the accounts were turned over to the Department for further collection efforts.
Grants and Contracts Management System	Awards, records, controls, and accounts for all discretionary grants and some formula grants.
Payroll Accounting System	Records, controls, and makes the Department's payroll disbursements.
Administrative Payments System	Records, accounts for, controls, and makes the Department's travel and other administrative expense disbursements; is run at the U.S. Department of Agriculture's National Finance Center.
Automated Procurement Document System	Creates requests for proposals and contract award documents and generates transactions to obligate appropriated funds.
Small Purchase System	Accounts for and controls disbursements for purchases of $25,000 and less and generates accounting entries for the general ledger system.
Budget Execution System	Records, accounts for, and controls apportionments of the Department's appropriated funds; prepares and issues formal apportionment documents for the Department's organizational components.
College Housing and Higher Education Facilities Systems	Awards and records loan, grant, and interest subsidy payments for the College Housing and Higher Education Facilities Programs.
Guaranteed Student Loan Interest Payment System	Records, controls, accounts for, and makes interest payments under the Guaranteed Student Loan Program as well as special allowance payments due private lenders.
Federal Insured Student Loan and National Direct Student Loan Collection System	Records, accounts for, and controls cash payments received on defaulted loans and repayments under the Federal Insured Student Loan and National Direct Student Loan programs.
Pell Grant Regular Disbursement System	Processes grant awards and administrative cost allowance payments to higher education institutions that have agreed to participate in the administration and management of the Pell Grant Program.
Pell Grant Alternate Disbursement Validation Tracking System	Records detailed information on individuals who apply for Pell Grant assistance through the Department's Pell Grant Alternate Disbursement program. This system maintains a data base of all students who receive Pell Grant payments through the Pell Grant Alternate Disbursement System.
Pell Grant Alternate Disbursement System	Calculates, awards, controls, and makes payments directly to Pell Grant applicants who attend higher education institutions that have elected not to participate in the administration and management of the Pell Grant Program.

(continued)

Name	Purpose
Guaranteed Student Loan State Agency Reinsurance System	Records, accounts for, and controls cash advances, claim payments, and administrative cost payments made to state guarantee agencies under the Guaranteed Student Loan Program.
Campus Based System	Records, accounts for, and controls all grants awarded to colleges and universities under the College Work Study and Supplemental Educational Opportunity Grant Program.
Guaranteed Student Loan-Federally Insured Student Claim Payment System	Awards, records, accounts for, and controls payments to lenders for defaulted loans insured directly by the federal government through the Guaranteed Student Loan Program.
Cuban Loan/Law Enforcement/Pell Collections System	Records, accounts for, and controls cash receipts and loans and grants receivable under the Cuban Loan, Law Enforcement, and Pell Grant Programs.
Training Obligation System	Accounts for and controls disbursements for training provided to Department employees.
Personal Property Management System	Records, accounts for, and controls government-owned property in the possession of contractors, and records, accounts for, and reports the purchase, transfer, and disposal of personal property used within the Department.
Veterans Cost-Of-Instruction Program Payment System	Records and processes grant awards payments to institutions to establish special programs to assist Vietnam war-era veterans in adjusting to college life.
Impact Aid Payment System	Records and accounts for Impact Aid payments to local education districts.
Indian Education Entitlement System	Records, accounts for, controls, and processes disbursements under Indian Education formula grants.
Formula and Block Grant Systems—comprises these six manual systems:	Awards and makes payments under formula and block grants to various state and territorial agencies programs.
Office of Elementary and Secondary Education Formula and Block Grant System	
Office of Educational Research and Improvement Formula and Block Grant System	
Office of Special Education and Rehabilitation Services Formula and Block Grant System	
Office of Bilingual Education and Rehabilitation Services Formula and Block Grant System	
Office of Vocational and Adult Education Formula and Block Grant System	
Office of Postsecondary Education Formula and Block Grant System	

Comments From the Department of Education

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE DEPUTY UNDER SECRETARY FOR MANAGEMENT

AUG 31 1987

Mr. Frederick D. Wolf, Director
Accounting and Financial
Management Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. Wolf:

Thank you for the opportunity to comment on the draft audit report dated July 15, 1987 entitled "Financial Management: Top Management Emphasis Needed to Improve Accountability at Education."

See comment 1.

We have made significant progress in strengthening and integrating the financial management functions at the Department since GAO completed its field work and certain aspects of the findings no longer apply as corrective action has been completed. We still have considerable work to accomplish before we realize our goal of a single, fully integrated, financial management system at the Department of Education (ED).

See comment 2.

GAO's report identifies deficiencies in the Department's financial management systems and demonstrates adverse effects from those weaknesses. The report, however, fails to develop the underlying causes for the deficiencies you cite and the recommendations are so broadly stated and outdated that they have a limited use to us. In many places in the report, the use of budget terms and numbers are inaccurate. Due to the seriousness of the allegations in the report with regard to student aid programs and the numerous inaccuracies, we do not believe the report should be issued until your staff meets with the appropriate ED staff to discuss the report's content.

We offer the following responses to your individual findings:

GAO Finding

"Loan records for the Department of Education's $2.6 billion college housing and academic facilities loan portfolios were inadequate."

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202

Page 2 - Frederick D. Wolf

ED Response

See page 15.

The College Housing and Academic Facilities loan programs have recently undergone significant changes with the advent of our loan asset sales program under which the Chemical Bank of New York is acting as our financial advisor. ED has recovered $499 million over the past year by discounting $792 million in loans. Chemical Bank is working with us to complete the loan files prior to sale. The audit report quotes a consultant's estimate of $75 million to clean-up the loan files. This is misleading, however, in that the $75 million actually referred to the total transaction costs estimated by the consultant. In fact, total transaction costs will be much lower than that early estimate. Moreover, because of ED's discounting program, our use of a sampling methodology for rating the loans, and our in-house work to clean-up the files, the final clean-up costs will be a fraction of the transaction costs.

GAO Finding

"The department lacks adequate accounting for and control over property, much of which is held and used by contractors and grantees."

ED Response

See pages 17 and 18.

ED identified the need for improved accountability over personal property as a result of an internal accounting review completed in 1986. As a result of that review, we decided to survey other Federal agencies to find the best property management system that would meet all of our needs. In keeping with Reform 88, our plan was either to acquire an existing system to avoid development costs or seek a cross servicing arrangement, wherein we would use a system operated by another agency. We subsequently entered into a cross servicing agreement with the Department of Agriculture's National Finance Center (NFC). We believe our agreement with NFC has resulted in the most cost effective way to strengthen personal property accountability at ED.

Regarding property held by contractors and grantees, the GAO report makes little or no distinction regarding accountability for property held by contractors versus that held by grantees. The report appears to conclude that all property should be treated as if it had been purchased directly by ED.

The report states that ED "owns" the property purchased under grants - including formula grants. We disagree. Except under very unusual circumstances, property purchased under a grant remains with the grantee subject to general government-wide disposition requirements, even after the grant expires.

Page 3 - Frederick D. Wolf

Regulations under Chapter 34 of the Code of Federal Regulations, Subchapter 74.133, and Chapter 41 of the United States Code, Subchapter 1892 state that, subject to obligations and conditions set forth in the award document, title to real property, equipment, and supplies acquired under a grant or subgrant shall vest, upon acquisition, in the grantee or subgrantee.

We are responsible for maintaining accounting control of property held by contractors, however, regulations require us to rely on the records of our contractors as the basis for official property records under the contract. ED is in the process of implementing a Grants and Contracts Management System which, supported by the NFC system, will track and control all property held by our contractors. This system is expected to be fully operational by December 1, 1987.

We believe all the weaknesses in accountability over personal property at ED will be eliminated with the implementation of the NFC system and the Grants and Contracts Management System.

GAO Finding

"The Department of Education relies on accounting systems run by schools to disburse $2.9 billion annually under its Pell Grant Program. GAO's review disclosed weaknesses in the schools' accounting systems which result in hundreds of millions of dollars in erroneous disbursements each year." Weak controls also impede collection of overpayments.

ED Response

See pages 18 and 19.

ED does not rely on accounting systems operated by postsecondary education institutions to disburse funds under the Pell Grant program. ED maintains not only summary records but also detailed accounting records for the Pell Grant program. The primary systems include a Pell Grant Application System which determines eligibility and a Pell Grant Disbursement System which operates on as close to a reimbursable funding basis as possible. ED advances only a limited amount of funds until schools submit detailed data which ED uses to authorize funds for payments that schools have already made to students and near term future payments. These payments are stringently edited, and any excess award amounts within a given campus are immediately disallowed. The school is responsible for any collections. ED returns feedback documents to schools which permits them to correct their records and adjust the student's payments.

Page 4 - Frederick D. Wolf

See page 22.

The Disbursement System also automatically identifies all students reported by more than one campus and alerts the schools to the potential for excess awards. We are about to implement an automated reporting procedure to notify the school, the appropriate ED collection office and/or the Office of the Inspector General of all cases where students who have attended multiple institutions have received excess payments. This reporting would not be possible if the Disbursement System did not already provide for the identification and recording of such cases.

See comment 3.

The audit report refers to many audit findings in prior audit reports including hundreds of millions of dollars in erroneous payments under the Pell Grant program. We need clarification of these findings to determine exactly where these errors occurred and whether they can be attributed to the Pell Grant program.

See page 22.

The audit report states that ED's accounting systems for the Pell Grant program do not record receivables and report information needed to preclude or collect overpayments. Until 1986, the law provided that a student's liability for overpayments at a school only precluded that student from receiving further Title IV funds at that school. It was the responsibility of the schools to collect such funds and prevent further awards. Since the activity was primarily between the school and the student, there was no need to establish accounts receivable at ED.

GAO Finding

"The accounting systems for discretionary grant and contract awards do not provide managers with the information needed to manage, control, and report on the more than $1 billion in contract and grant awards made each year."

ED Response

See page 24.

The audit report cites three instances where the current contract and grant information systems could not provide timely information and, based on those isolated instances, concludes that the system does not "... provide managers with the information needed..." The report does not acknowledge that the systems currently do provide timely information for over 500 routine requests per year. The three instances cited were not routine. Moreover we have already designed a successor system and will implement it in FY 1988. We anticipate that the new Grants and Contracts Management System will provide even more flexibility and responsiveness than the current system.

Page 5 - Frederick D. Wolf

GAO Finding

"Education's general ledger system, which should be used to manage its financial operations and be the source of the agency's financial statements, contains unreliable data because of inadequate and inefficient computer systems which support the general ledger and subsidiary accounting systems."

ED Response

See pages 26 and 27.

ED has been aware of the weaknesses in its accounting system. Much has already been done to improve this situation.

Our first priority has been to correct the data flowing into the general ledger from subsidiary financial systems. Implementation of a new payment system has already improved payment data. Other major systems which feed, and are subsidiary to, the general ledger are being reviewed and revised to improve this operation. We are also reconciling existing general ledger data with Treasury records and source documentation.

In addition to our efforts to improve the existing records, we have a major procurement under way to replace the current accounting system. We are evaluating alternatives including a cross servicing agreement with NFC to use their automated general ledger system and external reporting capabilities.

Additional ED Comments

See page 35.

In addition to our responses to individual findings, we wish to correct or comment on some other portions of the draft report.

The audit report states that ED does not maintain a system which provides for adequate follow-up on non-monetary determinations as a result of contractor and grantee audits. As a result of previous audit findings by ED's Office of Inspector General, the Management Improvement Service identified the lack of up-to-date written policies and procedures for follow-up on corrective actions as a weakness in ED's Audit Resolution System. ED has taken action to correct this weakness. All ED components with resolution responsibilities have submitted updated written procedures for follow-up on non-monetary findings related to audits of grantee and contractor operations. For example, the Office of Postsecondary Education's follow-up procedures rely heavily on subsequent audits to determine whether promised corrective actions have actually been completed.

Now on page 3.
See comment 4.

On page 4, the audit report discusses $600 million in erroneous awards by the Pell Grant program over a 2-year period. The audit report was not clear whether "erroneous" awards were really errors or whether they were the result of normal award adjustments required by the Pell Grant program. We must point out the distinction between error versus adjustments. Adjustments to awards are needed and occur as a result of students' course changes, but they should not be considered errors. We believe that the report needs clarification on this statement.

Now on page 10.
See page 18.

On pages 11 and 12, the statement is made that participating institutions "identify eligible students" for Pell Grants. Participating schools do not identify eligible students; ED through its Application Processing Systems identifies eligible students. The participating schools' involvement in determining student eligibility is limited to ascertaining that an eligible student is enrolled in an eligible program and is maintaining satisfactory academic progress.

Now on page 19.
See page 19.

On page 22, the statement is made that ED provides post-secondary educational institutions with cash advances to make payments to students and to help reimburse their administrative costs. The Pell Grant program does not provide cash advances to schools for administrative costs. Pell Grant administrative costs are reimbursable ($5.00 per recipient) when supported by detailed student records.

Now on page 50.
See page 50.

On page 59, the statement is made that ED's payment management system is run by the U.S. Department of Agriculture's National Finance Center. This is not correct. Our Payment Management System is maintained at the U.S. Department of Health and Human Services.

ED Conclusions on GAO Recommendations

GAO's recommendations are to: (1) develop an overall design for a department-wide financial system; (2) communicate to department operating managers top management's emphasis for internal departmental financial management improvement; (3) develop and implement an audit tracking and follow-up system for non-monetary recommendations; and (4) revise the department's planning and budgeting system for automatic data processing (ADP) plans to put financial management projects in a priority order and document discussions and decisions regarding the funding of projects. In making these recommendations, we do not believe GAO fully considered the efforts under way at the time

See pages 30, 36, 37, and 38.

of or since the audit field work. As discussed above, ED has been making substantial improvements in its department-wide financial system. With respect to the second recommendation, top management has consistently emphasized the importance of financial management improvement. We have also updated written procedures for follow-up on non-monetary audit recommendations, as addressed above. Finally, ED is continuing to make progress in our ADP planning and budgeting process and have made financial management projects a major funding priority.

See comment 5.

In conclusion, we believe the draft audit report should undergo major editing before it is released. We believe that some of the statements offered as "evidence" do not constitute adequate documentation and that samples used were not sufficient. We believe many of the issues contained in this report such as accountability for Pell Grant funds, property accounting, and management's emphasis on improvement of its financial management system should be discussed with ED staff so that misconceptions can be resolved and the information in the report brought up to date before a final audit report is issued.

We will be happy to arrange for your staff to meet with the appropriate ED staff to discuss the issues mentioned in this report in greater detail.

Sincerely,

Mary M. Rose

Mary M. Rose
Deputy Under Secretary
for Management

The following are GAO's comments on Education's Deputy Under Secretary for Management's letter dated August 31, 1987.

GAO Comments

1. The report title has subsequently been changed.

2. The report focuses on evaluating the adequacy of financial management information provided Education's managers to support day-to-day management of program and administrative operations and to support effective control over appropriated funds and other resources. Consequently, the causes of the financial management system deficiencies are expressed in terms of the lack of reliable information provided managers. In addition, the recommendations in the report, rather than addressing specific, technical system design improvements, deal with broad management actions which we believe that the Secretary needs to take to foster financial management improvements. We reviewed Education's detailed comments and did not find specific references to inaccuracies in budget terms and numbers. In addition, we met with Education officials to discuss our draft report and have included their comments where appropriate.

3. The report clearly refers to summary information on audit reports relating to school Pell Grant Program operations. Recommendations and pledged corrective actions are currently being tracked by Education's Office of Postsecondary Education. Both the schools and the Office of Postsecondary Education have acknowledged the validity of the audit findings and recommendations. Our report also refers to a previous GAO report that discussed the effectiveness of school actions to correct audit weaknesses. Education commented on this report when it was issued.

4. This comment refers to a statement in the executive summary which is explained fully in the text on page 21. The issue raised by Education is discussed in the previous GAO report as noted in the text of our report.

5. In response to Education's concerns, we discussed our draft report with Education officials. We received additional details on the actions Education has accomplished or planned to address the issues discussed in our report. This information is reflected in our report as appropriate.

*U.S. G.P.O. 1987-201-749:60206
(901392)

Requests for copies of GAO publications should be sent to:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each publication are free. Additional copies are $2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.